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Proposition 26 and the Impact on the Transportation Tax Swap

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Pursuant to County Counsel review, below is a brief outline of the impacts of Proposition 26 on the transportation tax swap adopted pursuant to AB 8X 6 (Chapter 11, Statutes of 2010), which eliminated the sales tax on gas and replaced it with an increased excise tax on gas and sales tax on diesel, and AB 8X 9 (Chapter 12, Statutes of 2010), which codified the allocation formula and other transit funding provisions. In summary, they are concerned that both the 17.3 cent gas tax or Highway User Tax Account (HUTA) funds and 1.75 percent rate increase of the sales tax on diesel for transit adopted to replace the sales tax on gas will be in jeopardy in November of 2011, within twelve months of enactment of Proposition 26, without a re-enactment of the replacement taxes by a two-thirds vote of the Legislature.

Counsel thinks there is a substantial risk that a court will disagree with the Legislative Analyst Office's (LAO) assumption that the sales tax is reinstated when the highway user tax and rate increase of the sales tax on diesel are voided. Although the LAO has articulated an equitable argument to reinstate the sales tax, counsel can not say with any certainty of success how the court might rule on this issue.

Their conclusion is to seek re-enactment of the taxes (AB 8X 6 provisions) by a two-thirds vote of the Legislature recognizing that Proposition 22 now precludes a simple re-enactment of the two bill package adopted in March of 2010. Any re-enactment of the provisions that includes allocation of these funds for General Fund relief (AB 8X 9 provisions) is now complicated by the fact that this is precluded by Proposition 22, which prohibits the use of transportation funds for General Fund relief or any other purpose other than for transportation whether through temporary borrowing or a permanent taking.

Real Life Implications

Without re-enactment of the replacement tax provisions of the swap, \$2.5 billion generated annually from these revenue sources will be in jeopardy beginning in November 2011. This revenue would otherwise be distributed annually as follows:

- Approximately \$1 billion for General Fund Relief (although Proposition 22 prohibits this expenditure into the future)
- 12% for the State Highway Maintenance, Safety and Protection or SHOPP
- 44% for the State Transportation Improvement Program or STIP
- 44% for local streets and roads allocated equally to counties and cities
- \$120 million for transit from the sales tax on diesel increase.

This loss to transportation would equate to job losses estimated at 27,000 based on a \$1.5 billion allocation for transportation and 45,000 jobs should the entire \$2.5 billion be available for transportation purposes.

Below is a more detailed summary of the relevant provisions and counsel conclusions:

Summary of Relevant Provisions of Proposition 26

New Article XIII A § 3 (a) provides “Any change in state statute which results in any taxpayer paying a higher tax” must be imposed by a 2/3 vote of the Legislature. Notice that the language applies to “change in state statute” not to “any statute.”

New XIII A § 3 (c) provides “any tax adopted after 1/1/2010, but prior to the effective dates of this Act, that was not adopted in compliance with the requirements of this section is void 12 months after the date of this Act unless the tax is reenacted by the Legislature and signed into law by the Governor in compliance with the requirements of this section.”

Summary of Conclusions Regarding Impact of Proposition 26 on the Swap

The tax increase is not void until 12 months after the effective date of Proposition 26. Counsel believes this is self executing. In other words, it will not require someone to sue to have non-complying taxes repealed. However, since the tax increase went into effect immediately and the initiative does not specifically provide for return of monies collected under a tax declared to be void at a future date, they conclude local governments can continue to receive these funds for the 12 month period following the effective date of Proposition 26, and that local governments can not be compelled to return those funds it properly receives.

Assuming the Legislature does not re-enact the provisions of the tax swap by a 2/3 vote, what is voided by § 3 (c) is a tax that does not comply with § 3 (a) – that is, any part of AB x8 6 that results in any taxpayer paying a higher tax – the increases, not the decreases. The tax decreases do not have to be approved by a 2/3 vote. As such, counsel thinks it is very likely that a court will disagree with the LAO’s assumption that the sales tax is reinstated when the highway user tax and sales tax on diesel are voided.

Counsel concluded that a legislative, rather than legal, solution to this problem should be the main focus. This would involve re-enactment of the replacement tax provisions using a 2/3 vote. This is the most expeditious and certain means of securing the funds for transportation into the future. However, there will be complications with re-enacting the entire two-bill package, given the new restrictions of Proposition 22 that prohibit the allocation of these funds for General Fund relief as provided for in AB 8X 9.